



CITY OF WINCHESTER, VIRGINIA

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November 15, 2005

To the Honorable Mayor and Members of the City Council
To the Citizens of the City of Winchester
Winchester, Virginia

Ladies and Gentlemen:

The Comprehensive Annual Financial Report (CAFR) of the City of Winchester, Virginia for the fiscal year ended June 30, 2005 is submitted herewith pursuant to Section 15.1-166 & 167 of the Code of Virginia. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of all the funds of the City. All disclosures necessary to enable the reader to gain an understanding of the City's financial activities are included.

The Comprehensive Annual Financial Report is presented in four sections:

Introductory Section - This section is designed to give the reader of the report basic background information about the governmental unit as a whole. It includes the table of contents, a listing of principal officials of the City, an organizational chart, the letter of transmittal, and the Certificate of Achievement for Excellence in Financial Reporting.

Financial Section - This section includes the Management's Discussion and Analysis; the Independent Auditor's Report on the basic financial statements; the basic financial statements; required supplementary information; and other supplementary information.

Statistical Section - This section includes selected financial and demographic information, covering a period of ten (10) years.

Single Audit Section - The City is required to undergo an annual single audit in conformity with the provisions of U.S. Office of Management and Budget Circular A-133, Audits of States and Local Governments, and Non-Profit Organizations. Information related to this single audit, including the schedule of expenditure of federal awards, schedule of findings and questioned costs, and auditor's reports on internal control structure and compliance with applicable laws and regulations are included in this section of the report.

The City's management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft, or misuse; to ensure that adequate accounting data are compiled; and to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management.

State Statutes require an annual audit by independent certified public accountants. The accounting firm of Didawick & Knopp, P.C. performed the City of Winchester's audit for the fiscal year ended June 30, 2005. In addition to complying with the requirements set forth in the State Statutes, the audit was designed to comply with the requirements of the Single Audit Act of 1984 and related OMB Circular A-133. The auditor's report on the basic financial statements is included in the Financial Section of this report. The auditor's reports related specifically to the single audit are included in the Single Audit Section.

Generally accepted accounting principals require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Winchester's MD&A can be found immediately following the report of the independent auditors.

Profile of the City of Winchester

The City of Winchester is located in the northern tip of Virginia in the Shenandoah Valley. Winchester, founded in 1744, is the oldest city in Virginia west of the Blue Ridge Mountains. The City currently occupies a land area of 9.2 square miles and serves a population of 24,400. Two major interstate highways, I-81 and I-66, and four major state highways, Routes 50, 7, 11, and 522, provide direct access to eastern markets, including Washington, D.C., 72 miles away, and Baltimore, 97 miles away.

The City of Winchester has a Council/Manager form of government. The thirteen member Council consists of a Mayor and twelve Councilors who are elected at-large and serve for a period of four years. In the governance of the City, the Council is charged with the responsibility of establishing policies and enacting ordinances and resolutions. The City Manager is appointed by the Council, and is charged with the responsibility of administering daily operations and implementing Council directives.

The City provides a full range of services, including the following: police and fire protection; emergency response and rescue services; education; water and sewer services; refuse removal and disposal services; the construction and maintenance of highways, streets and infrastructure; parks and recreational activities; cultural events; parking facilities; transit services; social services; planning and zoning; and general administration. All moneys required to support these services are reflected in this report.

In June of 2005, City of Winchester and community representatives vied for the Title of "All America City" along with 30 other Communities. The City's program focused on three items: Our Health's Health and Human Complex; "Mission: Communicate" which is the City's effort to better connect with the Latino community; and the Boys and Girls Club of the Northern Shenandoah Valley- Caretakers Unit. The City of Winchester and nine other communities were named co-winners of the "All-America City" award. Winchester won the same title in 1991. Past "All-America Cities" have used the recognition to boost economic growth and reinforce community collaboration.

The CAFR includes all funds, component unit agencies, and boards and commissions for which the City is financially accountable. Financial accountability is defined as appointment of a voting majority of such an entity's Board, and either (a) the ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to, or impose a financial burden on, the City.

Based on the foregoing criteria, the financial activities of the following organizations are included in the financial statements for the reasons indicated:

- ◆ Winchester Parking Authority (WPA): The City of Winchester created the WPA to plan and foster the development of off-street parking facilities. The WPA is included in the accompanying financial statements as the City appoints all WPA members and is able to impose its will on the WPA.

- ◆ Winchester School Board (Board): The Board was created as a separate legal entity by the City to oversee the operation and management of its publicly funded primary and secondary schools. All members of the Board are appointed by the City's Common Council, which has the ability to impose its will upon the Board.

Financial activities of the following joint ventures and other related organizations are not included in the CAFR, but are disclosed in the notes to the financial statements in accordance with pronouncements of the Governmental Accounting Standards Board:

- ◆ Frederick-Winchester Service Authority
- ◆ Winchester Regional Airport Authority
- ◆ Handley Regional Library Board

The City maintains budgetary control as part of its fiscal management techniques. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the biennial appropriated budget approved by the City's governing body. The level of budgetary control (the level at which expenditures cannot legally exceed the appropriated amount) is established at the departmental level. Only the Common Council can revise the appropriation for each department. The City Manager is authorized to transfer appropriations within general government departments, and the School Board is authorized to transfer budgeted amounts within the school system's categories. As demonstrated by the statements and schedules included in the financial section of this report, the City meets its responsibility for sound financial management.

Local Economy

The City is the region's commercial, industrial, and medical center serving a 60-mile radius. Because of the City's position as a regional economic center and its extensive highway system, the City's work force is drawn from a substantially broader area. Employers in the area offer a wide variety of private sector jobs ranging from agriculture, forestry, and manufacturing, to retail, professional, educational, and medical services.

The City's largest employer is the Valley Health Systems, which owns and operates the Winchester Medical Center and other related services such as urgent care clinics, home health services, a childcare facility, and transport services. The Winchester Medical Center is a non-profit, regional referral hospital, serving the tri-state region surrounding the City. The 405-bed facility offers a full range of inpatient and outpatient diagnostic, medical, surgical and rehabilitative services.

Located within the City of Winchester is Shenandoah University, a United Methodist Church-affiliated institution, which was founded in 1875 in Dayton, Virginia, and moved to Winchester in 1960. Today, Shenandoah University has an enrollment of approximately 3,000 students. These students participate in more than 80 programs of study at the undergraduate, graduate, doctorate and professional levels in six schools: the College of Arts and Sciences, School of Business, School of Health Professions, Shenandoah Conservatory, School of Pharmacy, and School of Continuing Education.

The City of Winchester, the Winchester Public Schools, and Shenandoah University jointly operate Winchester Community Television on cable television channel 29. The purpose of this channel is to inform and educate the public about such information as the City's programs and services, Council actions, and scheduled meetings. The channel began operations in February 1996 and is supported through contributions from the participating organizations. The City also maintains a web page at www.ci.winchester.va.us, which provides an additional means of communicating with the public about the City's programs and services. The Winchester Public Schools maintains a web page at www.wps.k12.va.us, which provides information about the programs and services of the school system.

The Winchester Regional Airport, an all-weather general aviation airport, serves the area. The airport is operational twelve hours a day with on-call and U.S. Custom service available twenty-four hours a day. It is the official airport of the Virginia Inland Port Authority, which is fifteen miles south of Winchester. The

City participates with other user localities in a joint venture to operate the airport, and contributes a share of the local funding needed for the operations and capital requirements of the airport.

The City's commercial/industrial tax base accounts for 34% of the taxable real property value in the City. The City serves as the major retail center for the region. Apple Blossom Mall, an enclosed regional shopping center, contains Sears, Belk, and J.C. Penney as its anchors, along with an additional 85 specialty stores. Plazas such as Apple Blossom Corners and Pleasant Valley Market Place house Martin's, Food Lion, Staples, Circuit City, Kohl's, Office Max, and Books-A-Million. Also, serving the area are a Wal-Mart Supercenter, Lowe's, Home Depot, Big K-Mart, Target, T.J. Maxx, and Pier 1 Imports. The Old Town Mall, a pedestrian mall in the City's downtown, offers a wide range of specialty shops and restaurants.

The City's Economic Redevelopment Department and other regional economic organizations collaborate to facilitate economic growth in the City and the surrounding areas. The current efforts of the Economic Redevelopment Department include the development of a new 30 acre commercial park off of Valley Avenue, and the stimulation of continued retail development activities. The City has also been successful in obtaining grant funding for Redevelopment activities. The City is participating with the US Department of Housing and Urban Development through the Community Development Block Grant Entitlement Program which provides ongoing annual funding. In FY2006, the City has a Consolidated Plan to spend the annual allocation of roughly \$300,000. The major focus of the Community Development Block Grant Entitlement Funds is to encourage and support expanded homeownership opportunities and the rehabilitation of single-family homes within the City of Winchester.

In addition, the City's Old Town Development Board continues to successfully market the City's downtown. New businesses continue to locate downtown, while existing businesses thrive. The Old Town Development Board administers the Main Street Program, which concentrates on downtown revitalization- putting the traditional assets of downtown, such as unique architecture and locally-owned businesses, to work as a catalyst for economic growth and community pride. The efforts of the Winchester Old Town Development Board have earned it recognition for excellence in the field of downtown revitalization by meeting high standards of performance set by the Virginia Main Street Program and the National Trust for Historic Preservations National Main Street Center.

Long-term Financial Planning

Unreserved, undesignated fund balance in the general fund (23% of total Governmental fund expenditures) falls within the policy guidelines that Council has established for planning purposes. Twenty percent is the target for the City's fund balance.

As part of our strategic plan, the City has implemented a 20 year financial planning model to help project revenue and expenditures through the year 2025. Factored into the financial planning model are the future major capital projects. In FY 2006 the City will be issuing \$45 million in bonds for the Daniel Morgan Middle School renovations; the John Handley High School renovations; water plant upgrades, road improvements; and other building renovations. Renovations to Daniel Morgan Middle School, John Handley High School, and John Kerr Elementary School will continue through FY 2010. The total bond issue for the schools projects through 2010 will be approximately \$35 million. Operational costs for the newly renovated facilities will increase as the renovations are completed at a total approximate cost of \$1,725,000. The school renovations should take us well into the future to provide a quality education to all students in the City.

Relevant financial Policies

In December 2003, along with the fund balance policy, City Council adopted a debt obligation policy, which states that net debt as a percentage of assessed value will not exceed 4%. General obligation debt service and capital lease payments as a percentage of general governmental expenditures will not exceed 15%.

The City's investment policy is designed to allow the City to obtain the highest possible yield on available City financial assets, consistent with constraints imposed by its safety objectives, cash flow considerations, and Virginia State laws that restrict the placement of public funds. Accordingly, deposits were either insured by Federal Depository Insurance or collateralized in accordance with the Virginia Security for Public Deposits Act.

Major Initiatives

The City of Winchester is planning to upgrade specific treatment equipment at the Percy D. Miller water treatment plant. The upgrades will include the following:

- Sedimentation basin sludge removal equipment
- New electrical generator that will power the entire water treatment facility
- Conversion of the chlorine disinfectant equipment from gaseous to liquid chlorine

The sedimentation basin equipment is approximately 50 years old and has not been upgraded since its original construction. The equipment is in need of replacement. The plant, with a capacity of 10 millions gallons per day, has the capability of partial emergency generation of about 3.5 million gallons per day. A new generator will be able to give total emergency capacity to the plant. The gaseous chlorine system, used for disinfection, would be replaced by the much safer sodium-hypochlorite (liquid chlorine). The total project cost for these upgrades is estimated to be \$6 million and will be funded through General Obligation bonds.

There are several transportation related projects throughout the City planned through fiscal year 2009. With the expansion and improvements of Hope Drive, Piccadilly Street and Valley Avenue, the City expects to issue approximately \$15,500,000 in GO Bonds to finance these projects. The City will be working with the IDA and the Commonwealth of Virginia to offset the costs of the projects.

Awards and Acknowledgment

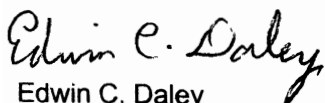
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Winchester for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004. This was the thirteenth year that the City of Winchester has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

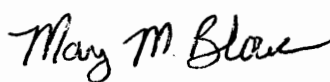
A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report was made possible by the dedicated and effective efforts of City and Schools Finance staff, and staff in other departments throughout the City who assisted in gathering the information for this report. Many hours of hard work are represented herein, and we extend our sincere appreciation to each member of our staff who contributed to the final report.

Finally, grateful appreciation is extended to the City Council for their leadership and support throughout the year.

Respectfully submitted,


Edwin C. Daley
City Manager


Mary M. Blowe
Finance Director


Celeste R. Broadstreet
Assistant Finance Director

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Winchester,
Virginia

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director